Where is the Nation in the Business Cycle?

The quick answer is "not where we want to be."

Economies perform in the course of what economists call a business cycle. Figure 1 provides a simple visual of a business cycle, which often resembles a roller coaster. Traits within the economy generally expand with time (such as GDP or employment), but that growth can be interrupted and even reversed for short intervals.

An existing growth trend will climb and reach a peak and then start to reverse. This marks the beginning of a new business cycle. The cycle then enters a contraction phase. The point at which the contraction ceases is called the trough. The peak-to-trough contraction is oftentimes viewed as the "official" length of a recession.

From this trough the economy again begins to grow. This is called the expansion phase. It generally has two parts — a recovery and a prosperity period. The recovery period is climbing from the trough back to a level equal to the previous peak. This period — or portions thereof — can oftentimes be included in the recession's measured effect because recession consequences can last longer than the "official" recession length. The continued growth thereafter is the prosperity period and signifies that the economy is growing beyond its previous best and has outdistanced the recession.

The Great Recession pushed America into one of these business cycles. Let's look at where we are and allow history to guide its appraisal.

Recessions are generally defined by monitoring the value of the economic output produced, called the GDP.[1] Figure 2 compares the current Great Recession GDP flow with the historic performance of past recession GDP flows.[2] But GDP is only one economic trait in a business cycle. The performance of employment more directly influences the American public, so it is also represented in Figure 2 (the lines with bubbles) for historic comparison.[3] In quick summary, the current recovery is falling well short of the historic recoveries of past recessions.

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[1] Using an inflation-adjusted GDP (called Real GDP) eliminates inflation's distortion upon the value of the economic output.

[2] Past flows are represented as the average Real GDP performance of all post-1950 recessions excluding the Great Recession.

[3] Employment is seasonally adjusted to smooth out distortions that different seasons have upon employment levels. Employment change is represented by percentage change, and further presented in reference to the quarter of GDP trough.

The Great Recession GDP fell by over four percentage points from its peak to trough. The previous recession average GDP declines are just below two percentage points. The bigger drop this time comes across as a possible influencing factor in the recovery's lingering lag. Historically, it only takes two quarters for GDP to recover and move beyond its previous peak. In the current recovery, it took ten quarters to meet and surpass the previous peak. In past recessions, ten quarters beyond the trough would have GDP seven percentage points beyond the previous peak. This dissimilarity is why the current recovery is labeled lethargic and disappointing.

Employment presents an even more lackluster comparison. Employment rebounds naturally lag GDP rebounds. Recessions tend to squeeze inefficiencies out of the economy, and employment is often one of the variables squeezed most. Typically, employment takes five quarters beyond the GDP trough to equal pre-recession employment. The current recovery is 12 quarters beyond the GDP trough yet has recovered only one third of previous peak employment.

The reasons for such results are varied, but historical performance reveals that the current recovery will isolate itself within the history of recoveries as a significant underachiever.

Figure 1: Anatomy of a Business Cycle

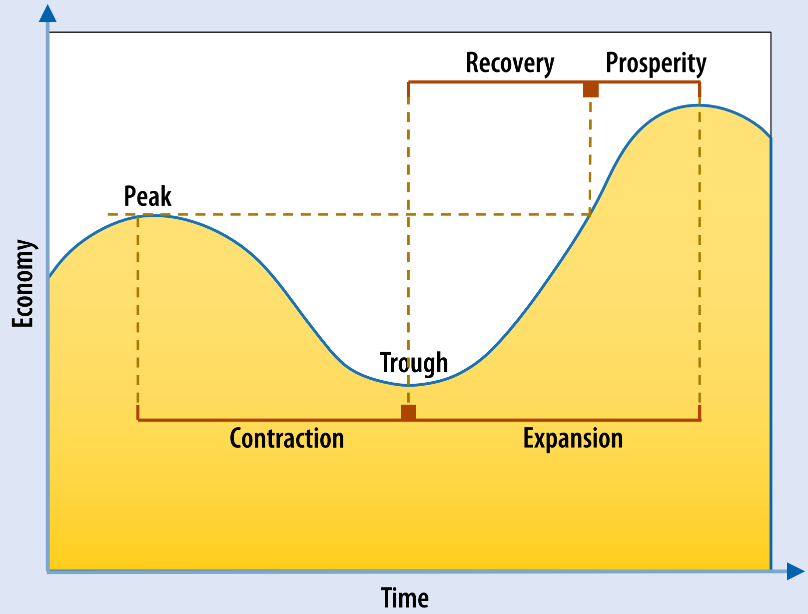

Figure 2: Historically Slow Recovery
for Both Gross Domestic Product and Employment